No. 83660-4

IN THE SUPREME COURT
OF THE STATE OF WASHINGTON

TIMOTHY JACKOWSKI and ERI TAKASE, Husband and Wife,

Appellants,

v.

DAVID BORCHELT and ROBIN BORCHELT, Husband and Wife; HAWKINS POE, INC., dba COLDWELL BANKER HAWKINS-POE REALTORS; HIMLIE REALTY, INC., VINCE HIMLIE, Broker for Windermere Himlie Real Estate, Real Estate Brokers, and ROBERT JOHNSON and JEFF CONKLIN, Real Estate Agents

Respondents.

SUPPLEMENTAL BRIEF OF ~~APPELLANTS~~ Respondents JACKOWSKI

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I. INTRODUCTION

Defendants Borshelts and Hawkins Poe have sought Supreme Court review of a decision of Division II of the Court of Appeals that held that the economic loss rule applies within limits clearly described by this Court in Alejandre v. Bull, 159 Wn.2d 674, 153 P.3d 864 (2007). Contrary to those limits, the Borschelts and Hawkins Poe seek to use the economic loss rule to reverse hundreds of years of caselaw on malpractice jurisprudence and judicial equity. The economic loss rule applies to delineate, define and defend the boundary between tort remedies and contract remedies, and to prevent the growth of a recent innovation in the law, a hybrid form of remedy called "contorts." However, it is not intended to undermine, and does not undermine, ancient remedies (such as judicial equity) or longstanding causes of action for professional malpractice. The Court of Appeals got the law right.

II. SUMMARY OF ARGUMENT

The economic loss rule bars a plaintiff from recovering *tort* damages in an *action at law* for *purely economic losses* when the parties' relationship, rights and duties *arise exclusively from and are governed exclusively by contract.* Alejandre v. Bull, 159 Wn.2d 674, 153 P.3d 864

(2007); Stuart v. Coldwell Banker Commercial Group, Inc., 109 Wn.2d 406, 745 P.2d 1284 (1987). On this formulation, the economic loss rule does not bar a plaintiff from seeking a contractual remedies. In this case, all of the remedies sought by the Jackowskis against both the Borshelts and Hawkins Poe can be understood as contractual. The Jackowskis had contracts with both (a purchase and sale agreement with the Borshelts and a professional services agreement with Hawkins Poe). The Jackowskis seek equitable rescission of the Borschelt contract. Equitable rescission is an equitable, contractual remedy. If there is no contract to rescind, there is no cause of action for equitable rescission of a contract.

Similarly, by agreeing to provide professional services to the Jackowskis, Hawkins Poe undertook to provide legally defined services. Part of the legal definition of a professional contract is that the professional will comply with professional standards. Failure to satisfy those professional requirements is the basis for a professional malpractice claim. However, those standards can be understood as implied-in-law terms of the professional contract, so an action for breach of them (malpractice) can be understood to be a contractual, not a tort, cause of action.

However, even if the breaches and causes of action presented in this case are not seen as contractual, the economic loss rule nonetheless does not bar them. The economic loss rule bars a plaintiff from seeking *tort damages* in an *action at law* for purely *economic losses* when the parties' *relationship is governed by contract.* It does not bar a plaintiff from seeking damages when the parties' relationship, rights and duties *do not arise exclusively from and are not governed exclusively by contract.* Professional relationships involve legal principles and rules (the rules that govern the profession) that are separate from and are not negotiable in the professional services contract. Therefore, the economic loss rule does not restrict recovery when sought in malpractice

Finally, when the economic loss rule applies, it bars a plaintiff from seeking one legal remedy (tort damages) when another, sufficient legal remedy is available (contract damages). It does not operate to foreclose equitable remedies (such as rescission) in appropriate circumstances. The rules of equity are self-governing and operate independently of the limitations on legal remedies (such as the economic loss rule). Equity applies when there is no sufficient legal remedy, so it would be both strange and unjust to have such an insufficient legal remedy act as a bar to the corrective action of equity.

III. ARGUMENT

A. The Economic Loss Rule Does Not Bar Equitable Claims

Equity exists as a corrective, to temper and provide nuance to the rigid structure of the law, which, when formally applied without the nuance of equity, produces unjust and unnecessarily harsh results in some cases. Equity exists to soften the hard edges of the law, to prevent the law from unfairly harming those seeking to navigate its passages. This case presents a near-perfect example of this relationship between law and equity, providing the Jackowskis with a remedy (equitable rescission of their contract with the Borschelts) in circumstances in which their contractual causes of action at law fail to provide a full or just remedy.

The equitable remedy (rescission) the Jackowskis seeks is not novel or unusual. A contract that is made based upon bad information (arising from mistake or misrepresentation) which would produce an unjust result if rigidly enforced, may be rescinded. Ross v. Kirner, 162 Wn.2d 493, 497-98 and 501, 172 P.3d 701 (2008); Sorrell v. Young, 6 Wn. App. 200, 224, 491 P.2d 1312 (1971). This rule frequently applies to real estate purchase and sale agreements. *See* Simonson v. Fendell, 101 Wn.2d 88, 675 P.2d 1218 (1984).

"In a system of contract law based on supposedly informed assent, it is in the interest of society as well as of the parties to discourage misleading conduct in the bargaining process." E. Allan Farnsworth, Farnsworth on Contracts, § 4.9 (3d ed. 2004). The party misled has an election to make between legal remedies and equitable remedies. An injured party to a contract can affirm the contract and get benefit of the bargain damages -- a cause of action at law in which the party recovers economic loss damages. Alternatively, the injured party can rescind and avoid the contract entirely, in which case the Court does not award damages but rather crafts a nuanced equitable remedy to unwind the contract and return each parties' consideration and other expenses related to the *res* of the contract.

This interaction between law and equity in the contractual context has several implications concerning the economic loss rule. Applying the economic loss rule, this Court has consistently held that parties to contracts, suffering only economic losses rather than injury to person or property, may only recover in contract. *See, e.g.*, Stuart v. Coldwell Banker Commercial Group, Inc., 109 Wn.2d 406 at 421-22, 745 P.2d 1284 (1987). (Court declined to recognize a cause of action for negligent construction and refused to "provide relief where the contract did not".);

Atherton Cond. Apt.-Owners Ass'n Bd. of Directors. v. Blume, 115 Wn.2d 506, 526-27, 799 P.2d 250 (1999) (tort recovery is an inappropriate remedy for economic damages). However, an equitable action for rescission of a contract is different from a tort action seeking tort damages in lieu of otherwise available contract damages under negotiated contract terms.

First, an equitable action for rescission of a contract is a *contractual remedy*, not a tort remedy. Contractual rescission applies only in a contractual context. Without a contract, there is nothing to rescind. Therefore, even if the Borchelts' over-bold and simplistic reading of the economic loss rule (that if the parties have a contract, the parties are strictly limited to contract remedies), equitable rescission would still be one of the Jackowskis' available remedies because equitable rescission is a contractual remedy.

Second, equitable remedies do not provide for a recovery of *economic losses*, as legal remedies do. Legal causes of action provide monetary damage compensation for some suffered harm; equitable causes of action attempt to reform the situation to mitigate or reverse the harm.

In arguing that Alejandre precludes the equitable contract remedy of rescission for misrepresentation, Borschelts' attorneys rely on a single

sentence: "the economic loss rule precludes any recovery under a negligent misrepresentation theory." Alejandre v. Bull, 159 Wn.2d 674, 677, 153 P.3d 864 (2007). However, this reliance highlights a fundamental mistake in Borschelts' argument. *Rescission* is not a *recovery* for harm resulting from breach of contract. *Rescission* is an *avoidance* of the harm caused by the contract. There is no economic loss rule caselaw where any court said that a plaintiff cannot receive the equitable remedy of rescission of a contract in lieu of economic loss damages.

In Alejandre, this Court held: "the economic loss rule applies where the parties could or should have allocated the risk of loss, or had the opportunity to do so." Id., at 687. With misrepresentations that go to the basis of the bargain, the deceived party is denied a real opportunity to allocate the risk of loss because the risk is concealed at the critical time in the negotiations when it could be allocated. Here, the Borchelts' and Conklin's misrepresentations and Johnson's incompetence meant that Jackowskis had no opportunity to allocate the risk of loss.

Thus, the Borschelts' attempt to use the economic loss rule to preclude equitable rescission of a contract fails for two reasons: 1. rescission of a *contract* is a *contractual remedy* and 2. *rescission* is not a *recovery of economic losses* subject to the economic loss rule.

B. The Economic Loss Rule Does Not Bar Malpractice Claims

Here, there are two sets of real estate agents: the buyers' agents, Johnson and Hawkins Poe, with whom Jackowskis had a contract and the sellers' agents, Conklin and Windermere, with whom they had no contract. Both sets of agents owed Jackowskis statutory duties. RCW 18.86.030. This review is sought by Johnson and Hawkins Poe, the Jackowskis' agent, with whom the Jackowskis had a contract. This presents issues similar to those above. Under the Jackowskis' contract with Johnson and Hawkins Poe, Jackowskis malpractice action may be contractual in nature (in which case it complies with the economic loss rule). If not, it arises from rights and duties that are independent of the terms of the professional services contract, and which are not subject to contract negotiation, in which case the economic loss rule does not apply.

The logic of Hawkins Poe's argument is as specious as it is simple. Hawkins Poe argues: 1. Professional malpractice is a tort action; 2. In this case (as in most cases of professional malpractice), there is a contract between the professional and client; 3. The economic loss rule bars any recovery in tort when there is a contract between the parties; 4. Therefore, this Court, by applying the economic loss rule, has abolished professional malpractice as a cause of action in Washington.

This argument is wrong. The error either lies in the first or the third premise (and may lie in both). First, professional malpractice, when there is a professional services agreement, may be a contractual cause of action, not a tort cause of action (the professional duties may be implied terms of the contract, so an action for breach of those duties may be a contractual cause of action just as an action for breach of an implied or statutory warranty is a contractual cause of action; Brickler v. Myers Const., Inc., 92 Wn. App. 269, 273-75, 966 P.2d 335 (1998)). Second, even if professional malpractice is a tort cause of action that cannot be recast in contract, the economic loss rule would not apply because the professional duties involved in a professional malpractice case arise from the general law governing the profession, not from the contract, and are not subject to contract negotiation or risk allocation.

The economic loss rule does not bar any contractual recoveries. Rather, the rule privileges contractual recoveries over tort recoveries by barring some tort recoveries when they duplicate an otherwise-available contractual recovery. Alejandre v. Bull, 159 Wn.2d 674 at 682-83, 153 P.3d 864 (2007). Contracts can include statutory duties and implied terms imported into the contract by law, and a lawsuit to enforce such duties or terms is contractual, even though the terms are implicit.

As between professionals and their clients, the professional standards and duties that provide the basis for malpractice claims can be conceptualized as implied terms of the professional services agreement. When a person hires a professional to provide professional services, that person is hiring the professional *as a professional*. That is, the professional necessarily, if implicitly, promises that he or she will act as a professional, providing the professional services in accordance with the ethical rules and performance standards of the profession. This promise is an essential term of any professional services contract ; it is what distinguishes *professional* service contracts from mere *personal* service contracts.

On this logic, Hawkins Poe's argument fails because, as between Jackowski and Hawkins Poe, Hawkins Poe's professional obligations have a contractual basis and Hawkins Poe's failure to perform its professional obligations is a breach of contract, entitling the Jackowskis to contractual damages (compensation for the harm they would have avoided if Hawkins Poe had performed to the standard of the real estate profession). In other words, when there is a professional services contract, professional malpractice is a contractual cause of action, not a tort cause of action, and is not barred by the economic loss rule.

Alternatively, professional malpractice may inherently be a tort cause of action, arising from rights and duties independent of the professional services contract and not subject to revision through contract negotiation and risk allocation. In such case, these duties are not "assumed only by agreement" (but rather are pre-assumed by the professional by virtue of his or her professional status), and a suit in tort for the breach of these duties is not barred by the economic loss rule. *See* Alejandre, 159 Wn.2d at 682.

Underscoring this logic, while these duties owed by the professionals do allocate risk between the professional and the client, the parties themselves had *no opportunity* to allocate the risk. Professional duties are non-negotiable. It is a violation of a professional duties to even ask that a client assume the risk of malpractice. When there is no opportunity to allocate risk, the economic loss rule does not apply. Alejandre, 159 Wn. 2d at 687. Therefore, the economic loss rule does not apply to claims of professional malpractice.

Washington courts adopted the economic loss doctrine at least twenty years ago. Stuart v. Coldwell Banker Commercial Group, Inc., 109 Wn.2d 406, 745 P.2d 1284 (1987). That adoption did not ring the death knell for the special status of professions and the consequent cause of

action for professional malpractice. Real estate agents are regulated professionals, and, even after Coldwell Banker, Id., plaintiffs have brought tort cases against real estate agents as professionals for breaches of statutory and common law duties; cases that were not barred by the economic loss rule. *See, e.g.*, Hoffman v. Connall, 108 Wn.2d 69, 736 P.2d 242 (1987) (real estate agents are professionals like lawyers, chiropractors, and doctors); Johnson v. Brado, 56 Wn. App. 163, 783 P.2d 92 (1990) (buyer sued broker and agent for negligent misrepresentation); Pacific Northwest Life Insurance Co. v. Turnbull, 51 Wn App. 692, 754 P.2d 1262 (1988) (buyer recovered against broker and agent for negligence).

If professional obligations are to be enforced in tort, not in contract, they must be separate and independent of the professional services contract, but must still apply. In such case, they are relevantly like the general rules governing negligent operation of a motor vehicle. If a person is injured when a contractor they hired to build their house runs them over with a truck, it is not a defense that they are suing in tort even though they did negotiate a contract term allocating the risk that the contractor would run over the customer. If professional obligations are

not implied contract terms, they are like the rules of the road, and can be enforced in tort by the client if the professional commits malpractice.

Seeing the weakness of their arguments under the seminal case on the economic loss rule, Alejandre v. Bull, supra., Hawkins Poe rests its arguments on Berschauer/Phillips Constr. Co. v. Seattle Sch. Dist. No. 1, 124 Wn.2d 816, 881 P.2d 986 (1994), which it cites for the proposition that this Court has already abolished causes of action for professional malpractice. However, Berschauer/Phillips did no such thing.

The Plaintiff in Berschauer/Phillips was a construction company that was hired by the Seattle School District to build a school. The plans and specifications prepared for the Seattle School District by professional engineers and architects proved defective and unbuildable. Berschauer Phillips incurred substantial extra construction costs and delay as a result of these design defects. Berschauer Phillips sued both the Seattle School District (with which it had a contract) and the design professionals (with whom it had no contractual or professional relationship).

The critical legal point at the heart of Berschauer/Phillips, ignored by Hawkins Poe, is that the design professionals did not owe Berschauer Phillips any professional obligations. Unlike Chapter 18.86 RCW, which provides that real estate professional do owe duties to third parties, there is

no such rule providing that design professionals owe professional duties to anyone other than their clients. Further, Berschauer Phillips had no contract with the design professionals. As Berschauer Phillips was owed no duty from the design professionals, the design professionals could not violate any such duty. Critically, Berschauer/Phillips supra., did not hold that the Seattle School District could not seek malpractice damages from the design professionals with whom it had a contract, and the Seattle School District successfully did so (by assigning this claim to Berschauer Phillips).

Hawkins Poe's simplistic argument fails. Either professional malpractice is a contract action, because professional duties form the basis of a professional services agreement, or professional duties are separate and independent from the professional contract, in which case they can be enforced (in a tort action for professional malpractice) separate from the contract. In either case, the economic loss rule is not a bar to an action for professional malpractice.

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IV. CONCLUSION

Hearing the appeal of this case, Division II of the Court of Appeals properly recognized that the economic loss rule applies within limits clearly described by this Court in Alejandre v. Bull, 159 Wn.2d 674, 153 P.3d 864 (2007) and properly ruled that the Jackowskis' claims fall outside those limits. The parties seeking further review, the Borschelts and Hawkins Poe, are asking this Court to expand the limits of the economic loss rule far beyond its current and proper limit.

This expansion of the economic loss rule would void hundreds of years of caselaw on malpractice jurisprudence and judicial equity. The Borschelts would have this Court remove equity from contract jurisprudence. Hawkins Poe seeks nothing less than a pronouncement that professional malpractice is no longer a cause of action in the State of Washington. However, neither the logic of the economic loss rule, nor the specific holdings of this Court in prior economic loss rule cases require such a radical revision and reversal of contract and professional malpractice law. Rather than undertaking a radical revision of Washington law, this Court should take this opportunity to more clearly state the purpose of the economic loss rule and the limitations on the application of that rule implied by its limited purpose.

The economic loss rule exists to define and defend the boundary between tort and contract. When the parties have a contract, and that contract provides the sum total of their legal relationship, then the parties' legal remedies are limited to those provided by the contract, and the parties are obligated to take care to negotiate the legal remedies they need when negotiating the contract terms.

However, this principle implies several limits. First, the economic loss rule is palatable and just as a hard-line rule restricting remedies to those defined by contract specifically because the safety valve provided by equity (equitable rescission of the contract) is an available remedy in cases in which money damages are not sufficient or are otherwise unjust. Second, because the justification off this rule is based on the parties' ability to negotiate a crafted-to-needs contract remedy, the rule does not make sense when such negotiation is improper or impossible, as it is in the professional malpractice context (as professionals cannot negotiate away their professional duties), or where on party does not disclose material information in the negotiations.

Alejandre v. Bull, 159 Wn.2d 674, 153 P.3d 864 (2007) and Stuart v. Coldwell Banker Commercial Group, Inc., 109 Wn.2d 406, 745 P.2d 1284 (1987) already contain the logic this Court needs to definitively

resolve the issues presented in this case. As applied in those cases, the economic loss rule bars a plaintiff from recovering *tort* damages in an *action at law* for *purely economic losses* when the parties' relationship, rights and duties *arise exclusively from and are governed exclusively by contract*.

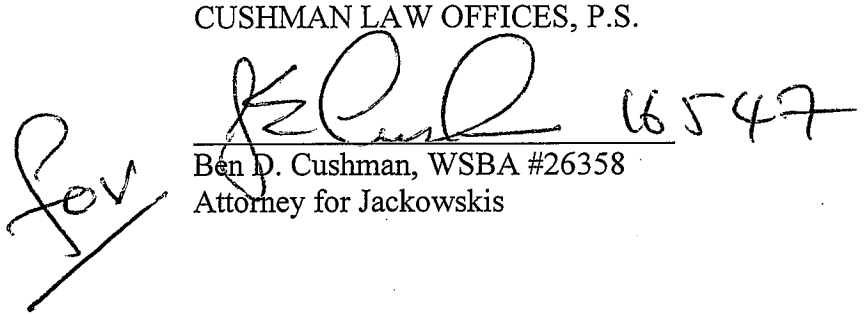
The equitable action against the Borschelts is proper because equitable rescission of a contract is a *contract*, not a *tort*, action, and because rescission is an *action in equity* not an *action at law*.

The malpractice action against Hawkins Poe is proper because a client's malpractice action against a professional can be characterized as a *contract* action, not a *tort* action, in which the professional standards are implied terms of the professional services agreement, so breach of those standards is a breach of contract. Even if malpractice actions are not recast from contract to tort, the action against Hawkins Poe is proper because professional relationships, which have rights and duties that arise from the professional status and obligations of the professional party, are not completely defined and limited by the terms of the contract and have rights and duties that are not subject to contract negotiation and risk allocation. The rights and duties involved in professional relationships *do not arise exclusively from and are governed exclusively by contract*, and,

therefore, the economic loss rule does not apply to limit them or to bar professional malpractice claims.

Respectfully submitted this 25th day of March, 2010.

CUSHMAN LAW OFFICES, P.S.



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CERTIFICATE OF SERVICE

Doreen Milward certifies and declares as follows:

1. I am a paralegal at Cushman Law Offices, P.S. I am over the age of 18, and not a party to this action.

2. On March 25, 2010, I sent via ABC Legal Messengers, for same business day delivery/filing, Jackowskis' Opening Brief to the Supreme Court in Olympia, Washington:

3. On March 25, 2010, I sent via e-mail (as previously agreed) and via U.S. Mail, first class postage prepaid, a true and correct copy of this same document to the following:

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